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SUBJECT: UNREALIZED POTENTIAL IN ECUADOR'S MINING SECTOR

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Classified by: DCM Andrew Chritton, Reasons 1.4 (b) and (d).

11. (SBU) Summary: The Ecuadorian government hopes to restart mining investment in Ecuador with a new law that increases the state share of revenues and control over the sector. Changes include reinstating royalties and tightening environmental controls, among others. The four major foreign firms present in Ecuador have indicated they can live with the law, but a number of issues still need clarification. End Summary.

12. (SBU) Ecuador's mining sector reportedly has great potential. The GOE estimates that Ecuador's major foreign owned concessions contain reserves of 22 million ounces of gold, 30 million ounces of silver, and 26.5 billion pounds of copper. However, the potential for the most part is unrealized, due to political and regulatory uncertainty in the sector. Ecuador's previous mining law, passed in 2000, eliminated royalties and favored investors, who began to set up operations in Ecuador. In 2006, GOE handling of environmental disputes and conflicts with local communities, as well as leftist President Correa's election increased political uncertainty in the sector. Correa promised a new mining law that would exercise greater control over the sector and secure a larger share of its revenues for the state. In early 2008, the GOE froze all mining activity and revoked numerous concessions for alleged violations (reftel a). In January 2009, the GOE finally passed a new mining law which increased many governmental controls (particularly environmental rules) and reinstated royalties.

Mining Law

13. (SBU) The new mining law lacks clear definition on many key issues, although the GOE is working on implementing regulations. The biggest change is the reinstatement of royalties (except for subsistence level artisanal mining), which must be at least 5% of sales and must be negotiated. Javier Cruz, former Executive Director of the Ecuadorian Mining Chamber, noted that this could put Ecuador at a disadvantage in the region, since he claimed the Latin American average was 3.7%. Mining companies must also pay 70% of extraordinary income to the state (as in petroleum contracts), although the base price for calculating this income is negotiable. The law provides stronger controls over many areas and more extensive and complex licensing requirements. In particular, environmental rules are much tougher, although procedures for obtaining environmental and other permits have not been simplified. A big disappointment for the industry is that the new law did not specify a single authority to coordinate necessary permits and licenses for mining.

14. (SBU) Concession terms are tighter than before, specifying acreage limits, time limits for each phase of mining, and higher concession fees. Mining Under Secretary Jose Serrano claimed that in the past, companies would obtain concessions and hold them, waiting for

commodity prices to increase - these new restrictions are an effort to stem speculation. In addition, new contracts must be negotiated when companies reach the exploitation phase, and arbitration of investment disputes is limited to Latin American forums. (Note: This may or may not be an issue for mining companies. In the past, the World Bank's ICSID has been the investor arbitral forum of choice, but most oil companies recently agreed to Latin American arbitral forums in their new contracts with the GOE.) The law also establishes a national mining company. Balancing out the restrictions, the GOE has enumerated a number of exceptions that could allow it to take advantage of mining investment, such as permitting mining in protected areas if it is in the national interest and approved by the President and Assembly.

Reactions to the Law

15. (SBU) Mining companies that already have a stake in Ecuador have indicated that they can live with the new law, although many issues still need clarification. Large mining companies operating in Ecuador in general appear relieved to have kept their concessions following the freeze in 2008, and to be able to restart operations. The high royalties and the 70% tax, numerous licenses required, and lack of specifics in the law remain concerns. On the other hand, we have heard that some of the smaller junior companies, which have more difficulty raising money, are displeased because they will have to pay higher concession fees than in the past and will have limited timeframes to complete each phase of the mining process (note: these are also the companies that might have been holding concessions waiting for prices to rise). Artisanal miners are angered by the law, for the most part, because they consider the environmental regulations too onerous (previously, this sector was basically unregulated). In some areas, they have taken to the streets in protest. Artisanal mining is considered the most polluting, since miners use uncontrolled chemicals and do not normally dispose of waste materials appropriately.

Mining Going Forward

16. (SBU) Four foreign companies own the largest mining projects in Ecuador - Aurelian (now owned by Kinross), IMC, Iamgold, and Ecuacorriente. (Note: All are Canadian, except IMC, which is a U.S. company registered in Toronto.) Major concessions are located in the southeast of Ecuador near the Peruvian border (Ecuacorriente and Aurelian), and in Azuay Province near the city of Cuenca (IMC, Iamgold). Ecuacorriente, a junior company, has one of the most advanced but also most controversial projects, an open pit copper mine (it was shut down in 2006 due to a dispute with the local community, reftel b). Obtaining the necessary permits under the new law could be problematic given local opposition to the project and the potentially more polluting nature of open pit mining. Aurelian's main project is "Fruta del Norte," a large, deep, gold deposit, with possible resources of 13.7 million ounces of gold and 22 million ounces of silver. Iamgold's project is located close to several water sources, which has caused some controversy over the possibility of water pollution. IMC has two small/medium sized concessions in Azuay province. None of the companies have yet reached the exploitation phase (early production could be reached in 2-3 years), but when they do they will be required to negotiate new contracts with the government. In the petroleum sector, the GOE has been attempting to transition to service contracts, and is expected to do the same in the mining sector.

Comment

17. (C) Ecuador's mining law was supposed to strike a balance between greater government control and more clarity for investors, and hopefully spur investment in a sector that has stagnated over the past few years. Already facing a lost year of revenues since it froze mining concessions in early 2008, the GOE is now seeking investment. But with suppressed mineral prices, and junior mining companies having trouble getting financing, Ecuador may have to do more than it expected to bring in desired investment. Correa's recent appointment of a new, more ideological Petroleum and Mining Minister, who promises "profound change in the management of energy and environment," adds additional uncertainty to the situation.

Developments in the mining sector show a not-surprising parallel to the petroleum sector, where uncertainty, distrust, and a lack of clarity have frozen potential investment and stifled the sector's potential.

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